

**Letter of Findings Number: 06-0535  
Sales and Use Tax  
For Tax Years 2003-05**

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**ISSUES**

**I. Sales Tax–Labor Charges**

**Authority:** IC § 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; 45: [IAC 2.2-1-1](#); [45 IAC 2.2-4-1](#); *Frame Station, Inc. vs. Indiana Dep't of Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002)

Taxpayer protests the assessment of sales tax on labor charges for manufactured signs.

**II. Tax Administration–Negligence Penalty**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#)

Taxpayer protests the imposition of a ten percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayer operates a sign manufacture and repair business in Indiana. Taxpayer manufactures, installs, and repairs all types of signs. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional sales tax and assessed negligence penalties for the tax years 2002, 2003, 2004, and 2005. The Department found that, based upon certain of Taxpayer's invoices, Taxpayer had not collected sales tax on materials that were used in repairs. In addition, the Department found that, based on certain of Taxpayer's invoices, Taxpayer had not collected sales tax on charges for labor for manufactured signs. In 2006, after completion of the audit, Taxpayer's business suffered an insurance-documented flood that resulted in Taxpayer's loss of documentation. Taxpayer protested this imposition of sales tax and penalties on the amounts that Taxpayer charged for labor for manufactured signs based on the best information available to Taxpayer. An administrative hearing was held, and this Letter of Finding results.

**I. Sales Tax–Labor Charges**

**DISCUSSION**

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC § 6-8.1-5-1(b).

The Department found that, based upon certain of Taxpayer's invoices, Taxpayer had failed to collect sales tax on charges for labor, which were performed in manufacturing the signs and occurred before the completed signs were transferred to the customers.

"Retail transactions" are subject to gross retail (sales) tax under IC § 6-2.5-2-1(a). A retail transaction is defined as occurring when a person "acquires tangible personal property... and transfers that property to another person for consideration." IC § 6-2.5-4-1(b)(1)-(2). Pursuant to IC § 6-2.5-4-1(e) the amount of the retail transaction that is subject to sales tax includes "the price of the property transferred" and "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." Further, [45 IAC 2.2-4-1\(b\)\(3\)](#) provides that amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail."

In summary, when services are performed or work is done to tangible personal property before the tangible personal property is transferred to the purchaser, then the amount of charges for the services or work done is subject to sales tax. Here, Taxpayer transformed raw materials into a new product (completed signs), which it then sold to its customers. The labor involved in creating the sign occurring prior to the transfer is included in the total amount Taxpayer charges and is included in the taxable amount as provided by [45 IAC 2.2-4-1\(b\)\(3\)](#).

Taxpayer disagrees with the Department's analysis and asserts that the Department erred in assessing additional sales tax liability over and above the amount of sales tax that Taxpayer had originally paid. Taxpayer maintains that the Department incorrectly assessed the additional tax based on the amount of charges that were stated separately on the customer invoices as labor charges. Taxpayer states that it has separately broken out the labor and materials costs and rightfully collected sales tax on only the materials portion. Taxpayer reasons that since the labor charges are stated separately, Taxpayer is not required to collect sales tax on the labor charges.

However, Taxpayer's reasoning assumes that the Department is relying on IC § 6-2.5-1-1 and [45 IAC 2.2-1-1\(a\)](#), which pertain to taxing "unitary transactions." A unitary transaction is a transaction that "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." IC § 6-2.5-1-1(a).

In *Frame Station, Inc. vs. Indiana Dep't of Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the court held that when customers were charged separate amounts for labor and materials for custom framing services the labor charges were subject to sales tax. *Id.* at 131. In arriving at that decision, the court reasoned that the focus of analysis should be "whether [Taxpayers'] services were preformed before or after it transferred property to its customers." *Id.* The court found that services that are performed prior to the transfer of the property are taxable, and services that are performed after the transfer of the property are taxable to the extent that the services represent a "unitary transaction" and are "inextricable and indivisible" from the property being transferred. *Id.*

Accordingly, the determinative fact is when the services were performed by Taxpayer. Since Taxpayer's services in manufacturing the signs occur prior to the transfer of the completed signs to the customers, the services are subject to sales tax. The fact that the services are listed as separated labor charges on the customers' invoices for the completed signs is not relevant.

#### **FINDING**

Taxpayer's protest is respectfully denied.

## **II. Tax Administration–Negligence Penalty**

#### **DISCUSSION**

The Department issued proposed assessments and ten percent negligence penalties for the tax years in question. Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides, "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Taxpayer has provided sufficient information to establish that its failure to pay the deficiencies were not due to Taxpayer's negligence, but were due to Taxpayer's exercise of ordinary business care as required by [45 IAC 15-11-2\(c\)](#).

#### **FINDING**

Taxpayer's protest to the imposition of the penalty is sustained.

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